

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

NOTICE OF ADJUSTMENT OF THE RATES)	CASE NO.
OF KENTUCKY-AMERICAN WATER COMPANY)	10069

O R D E R

On August 22, 1996, the Attorney General's Office ("AG") and Lexington-Fayette Urban County Government ("LFUCG") filed a joint request for rehearing of the Commission's July 31, 1996 Order authorizing Kentucky-American an annual increase in revenues of \$816,483 for the locked in period June 3, 1988 to July 3, 1989. Since the increase previously granted to Kentucky-American for this locked in period was \$842,483 annually, the impact of the July 31, 1996 Order was a net decrease and refund of \$28,167 for the 13 months. The AG/LFUCG raised two issues on rehearing: 1) cost of serving new customers; and 2) interest to be paid on the refunds. Kentucky-American filed a response in opposition to a rehearing on either issue.

In calculating its cost to serve new customers, Kentucky-American took its end of test period level of customers, then adjusted its revenues to reflect what would be collected from those customers for a full 12 months, and then adjusted O&M expenses to reflect those customers for a full 12 months. The methodology utilized by Kentucky-American to make this expense adjustment was a ratio of O&M expenses (less payroll costs) to revenues. The assumption underlying this methodology is that an increase in the number of customers served results in increased O&M expenses in the same ratio

as O&M expenses are to revenues. The AG/LFUCG maintained that this methodology was flawed because certain O&M expenses are fixed, not variable. Consequently, the AG/LFUCG recommended an adjustment based on a limited number of expense accounts that were readily identifiable as variable in nature. Kentucky-American, in its rebuttal testimony, challenged the AG/LFUCG adjustment and listed additional variable expense accounts not utilized by the AG/LFUCG.

The July 31, 1996 Order accepted Kentucky-American's adjustment on the grounds that the AG/LFUCG adjustment failed to analyze all O&M expenses to determine which ones were variable and properly includable in the adjustment. However, the Commission did find that not all O&M expenses are variable. Based on this finding, the AG/LFUCG challenges our acceptance of Kentucky-American's adjustment which is based on the assumption that all O&M expenses are variable. Based on a review of the July 31, 1996 Order, the Commission acknowledges that the findings on this issue are inconsistent and must be corrected. We are unable to determine from the existing evidence whether the O&M expenses incorporated in Kentucky-American's adjustment are all variable, which would indicate that our finding to the contrary was in error, or whether the O&M expenses are not all variable, which would indicate that the adjustment should be reduced. Consequently, rehearing will be granted.

On the second issue, the AG/LFUCG argues that the Commission should have granted interest on the amount to be refunded. Since this issue was not addressed in

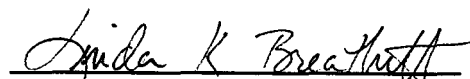
the July 31, 1996 Order, rehearing should be granted to afford the parties an opportunity to address whether interest should be paid on the refunds.

IT IS THEREFORE ORDERED that:

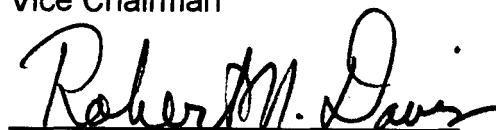
1. Rehearing is granted on the issues of the cost to serve new customers and whether interest should be paid on the refunds.
2. The procedural schedule set forth in Appendix A shall be followed.

Done at Frankfort, Kentucky, this 11th day of September, 1996.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A
APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 10069 DATED September 11, 1996.

Kentucky-American's prefiled testimony shall be
due no later than..... 10/01/96

All requests for information to Kentucky-American shall
be due no later than..... 10/11/96

Kentucky-American shall mail or deliver responses to
the requests for information no later than..... 10/23/96

Intervenor testimony, if any, shall be filed
in verified prepared form no later than..... 11/06/96

All requests for information to Intervenor
shall be due no later than..... 11/15/96

Intervenor shall mail or deliver responses to
requests for information no later than..... 11/25/96

Public Hearing is to begin at 10:00 a.m., Eastern
Standard Time, in Hearing Room 1 of the Commission's
offices at 730 Schenkel Lane, Frankfort, Kentucky,
for the purpose of cross-examination of witnesses
of Kentucky-American and witnesses of the Intervenor.....To be scheduled